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BEFORE THE FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY
FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D. C.

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FCC - MAIL ROOM

In the Matter of)
Simplification of the)
Depreciation Prescription)
Process)

CC Docket No. 92-296

COMMENTS OF THE
MICHIGAN PUBLIC SERVICE COMMISSION STAFF

On December 10, 1992, the Federal Communications Commission (FCC) adopted a Notice of Proposed Rulemaking (Notice) seeking comment on proposals that would simplify procedures and reduce associated costs in the FCC's current depreciation prescription process. Comments in this docket are to be filed on or before March 10, 1993. The following are the comments of the Michigan Public Service Commission (MPSC) staff.

Introduction

In its Notice, the FCC invites comments on four distinct options to develop a depreciation prescription process that would replace the current system whereby the FCC prescribes the rate at which the cost of common carrier plant will be allocated to operating expenses over the life of the plant.

Background

Pursuant to Section 220(b) of the Communications Act, any individual carrier's requested depreciation rate changes are reviewed approximately every three years. To prescribe depreciation rates for each plant account, the FCC employs a formula which relies upon life and salvage forecasts. Carriers submit detailed analyses on what they believe these forecasts should be. Once a rate

is developed, it is then applied to the average monthly account plant balance to calculate the depreciation expense for that account.

The current depreciation process was developed at a time when most carriers were subject to rate of return/rate base regulation. Because depreciation expense is a major determinant of prices under that system, detailed analysis of depreciation rates was necessary to ensure reasonable prices. Today, all but two of the carriers for which the FCC prescribes depreciation rates are under price cap regulation, which decouples the direct relationship between depreciation expense and prices. At the same time, carriers are concerned that their annual cost of determining depreciation rates ranges from \$35 to \$50 million industry-wide. In light of these regulatory and market changes, along with the high costs of depreciation analysis claimed by carriers, the FCC is seeking comments on four possible ways to simplify the process.

The Four Options Proposed by the FCC

The Basic Factor Range Option

This proposal would establish ranges for the forecasts (basic factors) that are used in the depreciation rate formula. Under this option, for each applicable plant account, carriers would select the basic factors from within the ranges. The carrier would use those selections to develop their proposed depreciation rates. These rates would continue to be applied to the plant account balances to calculate depreciation expense. This approach allows carriers to avoid filing extensive data to support their proposed basic factors for the depreciation formula. However, carriers having data that would support basic factors outside the ranges would be allowed to file detailed analyses and request authority to use rates based on the "unique" factors. While costly at

times, this proposal allows carriers to target their efforts and depreciation rates toward those accounts that most need attention.

The Depreciation Rate Range Option

Under this proposal, the FCC would establish ranges of depreciation rates for applicable accounts. Carriers would select a rate from within the range for an applicable account and apply that rate to the plant account balance to determine depreciation expense. This option would by-pass not only the basic factor determination stage, but also the depreciation formula. Further, it eliminates any relationship between a carrier's experience and appropriate life and salvage factors.

The Depreciation Schedule Option

The FCC would establish depreciation schedules that would allow 100 percent recovery of plant investment over a fixed period. This option would establish schedules of service lives, retirement patterns, and salvage values for applicable accounts. A carrier would determine its depreciation expense by applying the schedule for a particular account to its investment by vintage. This proposal eliminates any uniqueness for individual carriers and forces them all to use the same schedule which is not likely to be appropriate for any single carrier.

The Price Cap Carrier Option

Under this option, price cap carriers would be allowed to file proposed depreciation rate changes without supporting data. The proposed changes would continue to be placed on Public Notice and the FCC would prescribe depreciation rates based on carriers' proposals and the comments submitted on them. This

proposal also would eliminate the need for the three-way meetings now conducted among representatives of the FCC, state commissions, and companies. Being a depreciation rate proposal, this option also eliminates any relationship between a carrier's experience and appropriate life and salvage factors.

MPSC Staff Recommendation

The MPSC staff recommends the FCC adopt the Basic Factors Range Option. This would allow the carriers to select the future net salvage (FNS), projection life, and survivor curve for each applicable account from within an established range. These factors would then be used to derive the parameters that determine the depreciation rate. Carriers would then apply those rates to the applicable account balances to calculate their depreciation expense. This option would simplify the current process because carriers would no longer be required to submit the detailed analyses to support their proposed projection lives, survivor curves, and FNS values.

Eliminating these submissions would produce an administrative cost saving. This approach also would provide carriers with a greater degree of flexibility than they have experienced under past regulation of depreciation. The MPSC staff agrees with the FCC that this option would not eliminate the need for carriers to analyze underlying depreciation factors to determine the reasonableness of their depreciation expense and that with a diminished FCC role in determining depreciation expense levels, a greater responsibility will be placed on the carriers and their independent auditors to impose the internal controls and review procedures that are necessary to ensure their reported depreciation expense is reasonable.

The MPSC staff agrees with the FCC's tentative conclusion that industry-wide data should serve as the initial basis for determining the ranges and that the LECs and IXCs should be considered separately. The MPSC staff agrees that the FCC should gain some experience with the use of ranges before the FCC establishes them for all accounts. The MPSC staff agrees with the FCC's tentative conclusion that this option should be mandatory for all carriers for all applicable accounts.

For carriers whose basic factors underlying their currently-prescribed depreciation rates do not fall within the ranges the FCC selects the MPSC staff agrees with the FCC's tentative conclusion that, because the basic factor ranges approach provides carriers with greater flexibility, carriers should be required to show a significant divergence between their expected depreciation expense and that resulting from the use of ranges before a waiver is granted.

The MPSC staff recommends the FCC implement the use of ranges over a three year period, mandating use at the time a carrier is scheduled for its normal depreciation prescription. We support allowing carriers to select their initial basic factors on the basis of the basic factors underlying currently-prescribed depreciation rates plus a specified percentage of change on an annual basis and it should be made consistent with the FCC's annual update process that carriers now use. We also support the conclusion that carriers would be required to maintain their continuing property records regardless of the reviewing process the FCC ultimately adopts. Continuing property records, records of the companies' plant investment, are necessary for accurate accounting records. The MPSC staff also agrees that the use of ranges

will reduce the need to review basic factors from once every three years to once every five years.

As for not including net salvage as part of the depreciation process to further simplify the process, the MPSC staff would not support this change. We would recommend that salvage continue to be included as part of the depreciation process because it is a part of the cost of the asset which should be allocated over the asset's service life.

The MPSC staff would also like to reiterate three points brought up in FCC Commissioner Duggan's concurring statement: (1) depreciation is the largest component of total telephone company expense and even a small change in depreciation rates can add up to a large change in total expenses; (2) depreciation expense is not a measurable out-of-pocket cost and because of the necessarily imprecise nature of such predictions about the useful life of an asset, depreciation is susceptible to overly optimistic treatment; and (3) many states rely upon the FCC's depreciation prescriptions. For these reasons, the MPSC staff feels that the other three options outlined in the FCC's Notice would not allow sufficient review of the depreciation expense area, nor would they necessarily result in depreciation rates that would be appropriate for each carrier.

Conclusion

Depreciation is an expense of doing business for any firm. For telephone companies, it is a very big expense. For most, it is among the largest costs they have and it is growing larger all the time as available communication services become more elaborate and sophisticated. For this reason, the MPSC

staff recommends that the FCC adopt the Basic Factor Rate Option as a means of simplifying the procedures and reducing associated costs in the FCC's current depreciation prescription process. This method would allow carriers increased flexibility in the depreciation process while eliminating the need for carriers to submit detailed studies in support of their proposed factors. This approach would still maintain some level of oversight by the FCC in order to be consistent with the FCC's statutory mandate to prescribe "the percentage of depreciation" carriers may charge to operating expenses.

Respectfully submitted by:



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